

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF
COMPREHENSIVE ANNUAL FINANCIAL REPORT
STATE OF INDIANA
July 1, 2002 to June 30, 2003

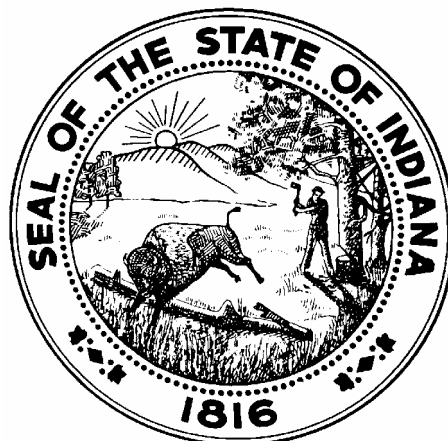


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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Governor	Mr. Frank O'Bannon Mr. Joseph Kernan	01-09-01 to 09-13-03 09-13-03 to 01-10-05
Auditor of State	Ms. Connie Nass	01-01-99 to 12-31-06
State Budget Agency	Ms. Marilyn Schultz	01-09-01 to 01-10-05



STATE OF INDIANA

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TO: THE OFFICIALS OF THE STATE OF INDIANA

We have audited the financial statements of the State of Indiana as of and for the year ended June 30, 2003, and have issued our opinion thereon dated December 29, 2003. The financial transactions of the State of Indiana are reflected in the State of Indiana's Comprehensive Annual Financial Report (CAFR).

In planning and performing our audit, we considered the internal controls over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain conditions in the design or operation of one or more of the internal control components that, in our judgment, need to be addressed by management to strengthen their internal controls.

The internal control conditions are disclosed in the following audit results and comments.

STATE BOARD OF ACCOUNTS

December 29, 2003

STATE OF INDIANA CAFR
AUDIT RESULTS AND COMMENTS
June 30, 2003

CAPITAL LEASES

The Procurement Division of the Indiana Department of Administration maintains a database of lease activity. Procedures in place to update the lease database do not ensure that all qualifying leases are entered into the lease database. This results in the database not being complete.

Adequate lease records should be maintained by the Department of Administration to ensure that lease obligations are properly presented in the State's financial statements in accordance with standards issued by the Financial Accounting Standards Board.

Each agency, department, institution or office is responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. Compliance is required, as applicable, with generally accepted accounting principles, and standards issued by the Governmental Accounting Standards Board, Financial Accounting Standards Board, and other standard setting bodies. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INFRASTRUCTURE

The Indiana Department of Transportation (INDOT) does not have complete written internal procedures to ensure that all applicable infrastructure assets are capitalized on the Auditor of State's capital asset system. INDOT has not documented procedures that would enable employees to determine which costs and at what point in the process these costs should be capitalized. This results in an understatement of the State's capital assets.

The Governmental Accounting Standards Board requires the capitalization of additions and improvements of a government's infrastructure assets.

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TRANSFERS

The Auditor of State did not have procedures in place during the audit period to ensure the proper recording of net transfer amounts in the financial statements. Journal Vouchers (JVs) are used throughout the year by the Auditor's office and various state agencies to record corrections, transfers between fund/centers, and adjustments to the state's accounting records. Procedures in place at the Auditor's office were insufficient to ensure that transfers within the same fund were reduced to appropriate net transfer amounts in the financial statements.

Upon our identification of transfer entries that were not properly recorded at net, the Auditor's office implemented changes in its procedures that should effectively resolve this condition.

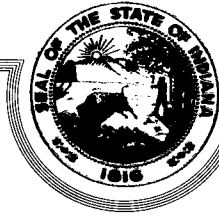
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STATE OF INDIANA CAFR
EXIT CONFERENCE

The contents of this report were discussed on June 30, 2004, with Ms. Connie Nass, Auditor of State; and Mr. Michael Landwer, Deputy Director, State Budget Agency. The contents of this report were also discussed on July 1, 2004, with Mr. Richard Whitney, Deputy Commissioner, Department of Transportation and on July 8, 2004, with Mr. Charles R. Martindale, Commissioner, Department of Administration. Their official responses to the audit findings have been made a part of this report and may be found on Pages 6 through 11.

Auditor of State

CONNIE KAY NASS



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To: Charles Johnson, III, CPA, State Examiner

From: Connie K. Nass, Auditor of State

Date: June 30, 2004

SUBJECT: RESPONSE TO AUDIT REPORT OF THE CAFR

This letter sets forth our comments on the Audit Report prepared by the State Board of Accounts for the State of Indiana Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2003.

CAPITAL LEASES

The Auditor of State's involvement with capital leases is limited to integrating the information provided by the Indiana Department of Administration into the CAFR before and after it has been audited by the State Board of Accounts. We agree with the audit results and comments provided by the State Board of Accounts.

INFRASTRUCTURE

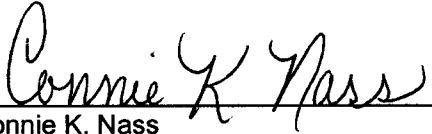
The Auditor of State's involvement with infrastructure is limited to integrating the information provided by the Indiana Department of Transportation into the CAFR before and after it has been audited by the State Board of Accounts. We agree with the audit results and comments provided by the State Board of Accounts.

TRANSFERS

We agree with the audit results and comments provided by the State Board of Accounts. At the time the State Board of Accounts found the problem with transfers, the finance department met with accounting department and State Board of Accounts and recommended two new procedures to correct these problems. These recommendations were formalized in an email sent to the finance department by Jennifer Marshall of the State Board of Accounts. The following procedures were implemented:

1. Modification of the journal voucher input process by the Auditor of State's MIS staff to allow for the insertion of lines. This was a change from the current entry process that necessitated missed lines having to be added to the bottom of the JV.
2. Change of procedure relating to the numbering of JVs from the current "batch" numbering to individual JV numbers for each submitted JV.

The accounting department has since implemented these procedures. As an added precaution the MIS system is now balancing transfers by JV as they are entered. In addition, this year the finance department has examined all of the transfers manually to identify any JV an agency has improperly written up, pairing the entries incorrectly. Those errors were manually corrected before preparing the transfer analysis.

A handwritten signature in cursive script, reading "Connie K. Nass", written over a horizontal line.

Connie K. Nass
Auditor of State

cc: Marilyn Schultz, State Budget Director



STATE OF INDIANA

Joseph E. Kernan
Governor

STATE BUDGET AGENCY

212 State House
Indianapolis, Indiana 46204-2796
317/232-5610

Marilyn F. Schultz
Director

July 8, 2004

Charles Johnson III, State Examiner
Indiana State Board of Accounts
302 W. Washington St.
Room E418, IGCS
Indianapolis, IN 46204

OFFICIAL RESPONSE

Dear Mr. Johnson:

This letter is in response to the Audit Results and Comments section of the State Board of Accounts examination of the Comprehensive Annual Financial Report that pertains to the responsibilities of the State Budget Agency.

The State Budget Agency is committed to improving the manner in which all financial matters of the State are handled. We will send a letter to the agencies you mention in your opinion letter of December 29, 2003, that report to the Governor, reiterating the standards found in the "Accounting and Uniform Compliance Guidelines Manual for State Agencies".

Specifically, we will discuss the maintenance of an adequate capital lease database with the Department of Administration. We are committed to improving the information provided on capital leases to ensure the proper presentation in the general purpose financial statements. We will also address the procedures necessary so infrastructure assets are capitalized on the Auditor of States system by the Indiana Department of Transportation.

We anticipate no further findings of this nature.

Sincerely,

Marilyn F. Schultz

cc: Governor Kernan
Charles Martindale
Bryan Nicol



STATE OF INDIANA

JOSEPH E. KERNAN, Governor

DEPARTMENT OF ADMINISTRATION
OFFICE OF THE COMMISSIONER

Indiana Government Center South
402 West Washington Street, Room W479
Indianapolis, Indiana 46204

July 16, 2004

Charles Johnson III, C.P.A.
State Examiner
State Board of Accounts
302 West Washington Street
Room E418
Indianapolis, IN 46204-2738

Re: Official Response to Special Review

Dear Mr. Johnson:

Enclosed please find the Indiana Department of Administration's response to an audit comment that will be included in the State of Indiana's Comprehensive Annual Financial Report.

If you should have any questions regarding the response please contact Jeffrey H. Underwood, Deputy Commissioner, Finance & Administration at 234-2409 or via email at junderwood@idoa.in.gov. Thank you.

Sincerely,

A handwritten signature in cursive script, reading "C. Martindale".

Charles R. Martindale
Commissioner

cc: Steve Abbott, Deputy Commissioner - Operations
Dan Dovenbarger - Deputy Commissioner and General Counsel
Jeffrey Underwood - Deputy Commissioner - Financial Management
J. Michael Degner - Controller

Capital Leases: In late 2001 the Department of Administration re-assumed the calculations and reporting for Capital Leases. Prior to that time the Board of Accounts had performed the task of gathering the information necessary to make those calculations and then entered them into a system that had been specifically developed for that purpose. Board of Accounts personnel provided us the process that they had used to gather the information concerning capital leases and the process behind the calculations. Essentially, they would review all Purchase Orders issued by the Department of Administration, as well as all of the Property Leases as accounted for by DOA personnel. The Board of Accounts would then contact approximately 10 agencies and request lease information from them. Some of these agencies were contacted annually, and others were contacted on biennial (2 year) basis. Using this process and data provided we enabled the capital leases functionality within PeopleSoft, entered in all of the leases from the Board of Accounts system. We then used the same information gathering process as used by the Board of Accounts.

In recognition that some leases might be excluded from the reports we included this as a goal for the State's e-procurement project. This project was implemented beginning October 2003 which requires that all agencies subject to, or utilizing the Department of Administration's Procurement division, to begin entering all purchases above \$500 for expenditure categories 3 (Services Contractual), 4 (Materials and Supplies), and 5 (Equipment) into PeopleSoft via a requisition and then issue a PeopleSoft Purchase Order. Beginning with fiscal year 2005 the Department of Administration will be able to run a report that captures all purchases that might be eligible for consideration as a capital lease. For the current fiscal year we will be relying on the survey process that has been used in past years as well as generating a report that will list all potential purchases that may have been entered into PeopleSoft during the fiscal year that may be considered a capital lease.



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JOSEPH E. KERNAN, Governor
J. BRYAN NICOL, Commissioner

Writer's Direct Line
(317) 232-5358

July 7, 2004

State Board of Accounts
IGCS, Room E418
Indianapolis IN 46204

Subject: Response to Audit Finding - - Fiscal Year 2003 CAFR

FINDING 2003-CAFR-2 INFRASTRUCTURE

The Indiana Department of Transportation (INDOT) does not have complete written internal procedures to ensure that all applicable infrastructure assets are capitalized on the Auditor of State's capital asset system. INDOT has not documented procedures that would enable employees to determine which costs and at what point in the process these costs should be capitalized. This results in an understatement of the State's capital assets.

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Department of Transportation's Response

Since the implementation of the GASB34 reporting requirements, INDOT has continued to work with the Auditors in developing procedures for reporting infrastructure activity. The Auditors and INDOT staff have recently agreed conceptually as to the type of reporting that is to be implemented for Fiscal Year 2005, starting July, 2004. As the specific procedures are developed and implemented to ensure that all applicable infrastructure assets are capitalized on the Auditor of State's capital asset system, such procedures shall be documented.

Signed: _____

Richard Whitney

Title: _____

Chief Financial Officer

Date: _____

7/7/04